December 28, 2004

OIL AND GAS DOCKET NO. 01-0240489

COMMISSION CALLED HEARING TO SUPERCEDE THE FINAL ORDER ISSUED DECEMBER 9, 2003 IN OIL & GAS DOCKET NO. 01-0233603 REQUIRING PLUGGING OF WELL NOS. 1 & 2 ON THE J. MACKIN (08440) LEASE, TENNEY CREEK FIELD, CALDWELL COUNTY, AND TO ENABLE TILMON OIL CO. TO BECOME THE OPERATOR OF RECORD AND TO PRODUCE THE ABOVE-REFERENCED WELLS.

APPEARANCES:

FOR APPLICANT:	**APPLICANT:**
Jon Mitchell	Tilmon Oil Co.

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

DATE OF REQUEST FOR ACTION:	August 20, 2004
NOTICE OF HEARING:	October 28, 2004
DATE CASE HEARD:	November 19, 2004
HEARD BY:	Marshall Enquist, Hearings Examiner
PFD CIRCULATION DATE:	December 28, 2004

STATEMENT OF THE CASE

This Hearing was set to consider the request of Tilmon Oil Co. (hereinafter "Tilmon") to supercede the Final Order issued December 9, 2003 in Docket No. 01-0233603 requiring plugging of Well Nos. 1 & 2 on the J. Mackin (08440) Lease, Tenney Creek Field (hereinafter "subject lease"), and to recognize Tilmon as the operator of record. Tilmon asserts that it can restore the wells to production and therefore the wells should not be plugged.

SUMMARY OF EVIDENCE

The examiner took official notice of the Final Order in Oil & Gas Docket No. 01-0233603, Commission records related to Tilmon's most recent Commission Form P-5 (Organization Report) filing on March 26, 2004, and Commission records identifying the wells for which Tilmon is currently recognized as the operator.

Tilmon filed its most recent Organization Report with the Commission on March 26, 2004, and has posted financial assurance with the Commission in the form of a $50,000 Bond. Tilmon currently operates 2 wells.

Tilmon's owner-operator, Jon Mitchell, appeared at the hearing and presented evidence in support of the application. Tilmon is the 100% working interest owner of both wells, and provided a copy of a new lease from the mineral owner.

The current Commission recognized operator of the subject lease, Stout Brothers, LLC (hereinafter "Stout"), submitted Commission Form P-4s (Producer's Transportation Authority and Certificate of Compliance), for both leases effective November 1, 1995. In Oil & Gas Docket No. 01-0233603, Stout was ordered to plug the J.Mackin Well Nos. 1 & 2 and pay an administrative penalty of $4,250 pursuant to a Final Order entered on December 9, 2003 for violations of Statewide Rules 14(b)(2) and 3(a). Tilmon has submitted a single-signature Form P-4 to designate itself as the operator of the subject lease and has stated that it has no officers in common with Stout or any connection to Stout. Stout received notice of this hearing at its P-5 Organization Report address, but did not appear in protest. The superceding order sought by Tilmon would be effective only as to transferring the ownership of the subject wells and removing the plug-only requirement. The Final Order in Oil & Gas Docket No. 01-0233603 would remain in effect as to the requirement that Stout pay an administrative penalty of $4,250.

Stout had produced the wells by swabbing, consequently all downhole production equipment, along with the pumping units, had been stripped. As part of its presentation, Tilmon presented a production history of the subject wells, showing combined production of 6567 BO in 1983, declining steadily to 262 BO in 1994 under Operator Larry Garner. Stout Brothers bought the wells in 1995 and, under their stewardship, combined production totaled 10, 12, 52 and 7 BO for the years 1996 through 1999. Stout reported no production from 2000 forward.

Tilmon believes the wells have suffered from neglect and hopes to significantly enhance production by acidizing the interval and injecting water and nitrogen. Tilmon proposes to replace the pumping units and restore production to a projected level of 720 barrels per year. The two wells had a combined production of 720 barrels of oil in 1988, when oil was selling for $15.81 per barrel. Because oil is currently selling for roughly three times that amount, Tilmon expects the project to be economically viable. Tilmon is acquiring leases on property surrounding these wells and plans to expand the scope of its operations.

AUTHORITY

Texas Natural Resources Code §85.049(a) provides:

> On a verified complaint of any person interested in the subject matter that waste of oil or gas is taking place in this state or is reasonably imminent, or on its own initiative, the commission after proper notice, may hold a hearing to determine whether or not waste is taking place or is reasonably imminent and if any rule or order should be adopted or if any other action should be taken to correct, prevent or lessen the waste.

Texas Natural Resources Code §89.041 establishes the affirmative statutory responsibility of the Commission concerning abandoned wells:

> If it comes to the attention of the commission that a well has been abandoned or is not being operated is causing or is likely to cause pollution of fresh water above or below the ground or if gas or oil is escaping from the well, the commission may determine at a hearing, after due notice, whether or not the well was properly plugged as provided in Section 89.011 or Section 89.012 of this code.

Texas Natural Resources Code §89.042(a) provides:

> If the commission finds that the well was not properly plugged, it shall order the operator to plug the well according to the rules of the commission in effect at the time the order is issued.

Texas Natural Resources Code §91.107 requires that an operator have, on file with the Commission, financial assurance in the form of a bond, letter of credit or cash deposit in the amount necessary for both existing wells operated and any wells being transferred, prior to Commission approval of the transfer.

Under Statewide Rule 14, the Commission may require a person seeking to be recognized as the operator of a well to provide evidence of a good faith claim of a continuing right to operate.

EXAMINER'S OPINION

Tilmon asserts that it can meet the requirements to be recognized as the operator of the subject lease and restore the wells to active production. However, this claim is complicated by the Final Order requiring that Stout plug the wells. An order superceding a Commission Final Order may be warranted if the operator shows: 1) that it has a good faith claim of a continuing right to operate the well or lease; 2) that it has met the financial assurance requirements of Texas Natural Resources Code §91.107; and 3) that a superceding order is necessary to prevent waste. Tilmon has satisfied all of these requirements.

The first two factors apply to all transfers of inactive wells, not just cases where a well is ordered to be plugged. Any operator seeking to acquire an existing well which has been inactive for more than 12 months must show that it has a good faith claim of a continuing right to operate the well upon demand by the Commission. This requirement is found in Statewide Rule 14(b)(2). Additionally, the operator must show that it has met the requirements of Texas Natural Resources Code §91.107 which preclude the Commission from approving the requested transfer of an existing well to a new operator unless the new operator has filed financial assurance with the Commission in the form of a bond, letter of credit or cash deposit.

In this case, a good faith claim of a right to operate the subject leases is established by virtue of the new lease. Tilmon also has a $50,000 bond in place which satisfies the financial assurance requirement under Texas Natural Resource Code §91.107.

Superceding a Final Order to Prevent Waste

Final Orders in Commission Enforcement Proceedings generally require an operator to plug a well for a violation of Statewide Rule 14(b)(2) if there is no reported production from the well (or injection for injection and disposal wells) in the past 48 months. These "plug-only" orders reflect the Commission policy, that in cases where a well is in violation of Commission rules and has not reported any production or injection activity for a lengthy period of time, that the Commission will require that the well be plugged.

To support these "plug-only" orders, a Finding of Fact identifies when the well or lease last reported any production or injection activity. An additional finding of fact addresses the statutory requirement in Texas Natural Resources Code §89.041, by finding that the unplugged well is causing or is likely to cause pollution of fresh water above or below the ground.

A "plug-only" order falls under the Commission's authority in Texas Natural Resources Code §89.042. Further, the courts recognize that a Commission order to plug a well "is entitled to the same weight and finality as an order granting or refusing a permit to drill a well." *Wrather Petroleum Corporation v. Railroad Commission*, 230 S.W.2d 388, 390 (Tex.App. - Austin 1950, *reh'g denied*) citing *Railroad Commission of Texas v. Gulf Production Co.*, 132 S.W.2d 254, 256, (Tex. 1939). Finally, the findings of fact are not "technical prerequisites" but satisfy a "substantial statutory purpose." *Morgan Drive Away, Inc. v. Railroad Commission*, 498 S.W.2d 147, 150 (Tex.1973); *Railroad Commission of Texas v. R. J. Palmer*, 586 S.W.2d 934 (Tex.App. - Austin1979, *no writ*).

In this case, the Final Order entered against Stout was a "plug-only" order. As noted above, Tilmon must show that a superceding order is necessary to prevent waste.

Application of Waste Standard

In this docket, the question is whether Tilmon presented sufficient evidence that an order superceding a "plug-only" order is necessary to prevent waste. It is the examiner's conclusion that Tilmon presented sufficient evidence to support the entry of a superceding order to prevent waste.

Tilmon proposes to restore production to the wells previously operated by Stout. The testimony supports Tilmon's claim that the wells were not capable of production due to neglect. Specifically, a review of the production history of the wells shows a sudden sharp drop in production during the time the wells were controlled by Stout. By installing new equipment, acidizing and repressuring the wells, Tilmon hopes

to restore them to productive status. The examiner expresses no opinion as to the likelihood of success in this venture to the degree that Tilmon anticipates. However, the risk that Tilmon's attempt to restore production may not be completely successful is not a basis for denying it the opportunity to restore production where Tilmon has met all the other requirements to operate the wells. It is likely that Tilmon's efforts will result in the recovery of at least some hydrocarbons that would not otherwise be recovered. Accordingly the examiner concludes that an order superceding the plug only provisions in the Final Order will prevent waste.

Based on the record in this docket, the examiner recommends adoption of the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

1. Tilmon Oil Co. (hereinafter "Tilmon") and Stout Brothers LLC (hereinafter "Stout") were given at least 10 days notice of this proceeding. Tilmon appeared at the scheduled time and place for the hearing through its owner-operator Jon Mitchell and presented evidence. Stout did not appear.

2. Tilmon filed its first Commission Form P-5 (Organization Report) with the Commission on March 26, 2004. Tilmon has posted financial assurance with the Commission in the form of a $50,000 bond.

3. Stout Brothers, LLC, (hereinafter "Stout"), was recognized as the operator of the J. Mackin (08440) Lease (hereinafter "subject lease") after filing Commission Form P-4s (Producer's Transportation Authority and Certificate of Compliance), effective November 1, 1995.

4. In Oil & Gas Docket No. 01-0233603, Stout was ordered to plug the J. Mackin Well Nos. 1 & 2 and pay an administrative penalty of $4,250 pursuant to a Final Order entered on December 9, 2003 for violation of Statewide Rules 14(b)(2) and 3(a).

5. Tilmon is the 100% working interest owner of the two wells, and provided a copy of the new lease with the mineral owner under which Tilmon will operate the wells.

6. Superceding the requirement in the Final Order entered in Oil & Gas Docket No. 01-0233603 that the J. Mackin Well Nos 1 & 2 be plugged is necessary to prevent waste.

   (a) Due to stripping of the wells and removal of their associated equipment, the J. Mackin Well Nos. 1 & 2 are currently unable to produce.

   (b) Re-equipping and repairing the associated equipment of the J. Mackin Well Nos. 1 & 2 and treating the wells chemically will allow them to be restored to production.

(c) The wells may produce up to 720 barrels of oil per year if acidized and then repressured with water and nitrogen.

7. The requirement in the Final Order in Oil & Gas Docket 01-0233603 that Stout pay an administrative penalty of $4,250 will remain in effect.

CONCLUSIONS OF LAW

1. Proper notice of hearing was timely issued to the appropriate persons entitled to notice.

2. All things necessary to the Commission attaining jurisdiction have occurred.

3. Tilmon has a good faith claim of a right to operate the subject lease.

4. Tilmon has filed financial assurance in the type and amount required under Texas Natural Resources Code §91.107 to be approved as the operator of the subject lease.

5. A Final Order superceding the Final Order entered in Oil & Gas Docket No. 01-0233603 requiring plugging of Well Nos. 1 & 2 on the J. Mackin (08440) Lease, Tenney Creek Field, Caldwell County, is necessary to prevent waste.

6. The Final Order in this Docket superceding the Final Order in Oil & Gas Docket 01-0233603 is effective only as to the disposition of Wells No. 1 & 2 on the J. Mackin (08440) Lease, Tenney Creek Field, Caldwell County, and does not relieve Stout Brothers LLC of their obligation to pay an administrative penalty of $4,250 to the Railroad Commission.

RECOMMENDATION

The examiner recommends that the Commission grant Tilmon's request to supercede the provisions in the Final Order entered in Oil & Gas Docket No. 01-02333603 requiring plugging of Well Nos. 1 & 2 on the J. Mackin (08440) Lease. The examiner further recommends that all other provisions of the Final Order in Oil & Gas Docket 01-0233603 remain in full force and effect.

Respectfully submitted,

Marshall Enquist
Hearings Examiner